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SUBJECT: ECONOMIC REFORMS STALL AS ELECTIONS NEAR

Classified By: Ambassador J. Thomas Schieffer for reasons 1.4 b/d.

#### Summary

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11. (C) Economic reform momentum has stalled in the run-up to Japan's Upper House elections in July, while policy talk shops have proliferated. Reform proposals that have made it through the bureaucratic gauntlet reflect a "tinkering" mentality, while PM Abe and the politicians on his economic team have toned down rhetoric on reform. The stall has empowered elements of the bureaucracy and the Diet who are content with the status quo, making the prospects for reform even after the July Diet elections more difficult. End summary.

#### Economic Reform Stalls; Committees Proliferate

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12. (C) Economic reform momentum has stalled in the run-up to July's Upper House elections, according to an increasing number of Embassy academic, business, and government contacts. Prime Minister Abe's preference for political and security issues; the public's perception that structural economic reform has worsened income and social disparities; resurgent bureaucratic power; Abe's weakness in corralling parts of the ruling Liberal Democratic Party (LDP); and "reform fatigue" are all cited as causes for the change.

13. (C) Simultaneously, government-sanctioned advisory groups studying reform have proliferated. Business contacts have been particularly critical about these advisory groups, wanting "more action and less talk." Overlapping mandates have no doubt contributed to the sense of a muddled system. For example, a recent cabinet-level addition to the groups, the so-called "Roundtable on Raising Growth," duplicates the academic, business, and union structure of the Ministry of Health, Labor, and Welfare's (MHLW) Labor Policy Council. It also overlaps membership with the Council on Economic and Fiscal Policy (CEFP), and aims at policy questions already under discussion at the CEFP, MHLW, and Cabinet Secretariat's

group under Finance Services and "Second Chance" Minister Yamamoto. Similarly, at least two groups are discussing the "Asia Gateway" strategy, with many of the issues discussed there overlapping with Ministry of Land, Infrastructure, and Transport groups on airports and aviation policy. We count three groups discussing the internationalization of Tokyo's financial markets and four different bodies reviewing health care policy.

14. (C) Moreover, complaints have arisen that the "policy competition" among these groups has not produced good counsel for the prime minister. Former Economic and Fiscal Policy minister and Koizumi-era reformer Heizo Takenaka was blunt in a recent newspaper interview when asked about the mid-term report from the Kantei's "Innovation 2025" council. While acknowledging the role innovation plays in economic growth, he lamented that the report had "no content" and "no specifics."

#### Motion In Lieu of Progress?

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15. (C) Measures that have emerged from the current policy process are often heavily watered down and offer limited change. As part of PM Abe's promise to address inequalities facing part-time workers, for example, the government and LDP came to agreement in March on a bill to expand the number of part-time employees eligible for corporate pension plans by lowering the threshold for participation from thirty working hours a week to twenty. Caveats added to the bill by entrenched business and political interests, however, excluded students (about one-fourth of part-timers) and workers at companies with fewer than 300 employees, and delayed implementation until 2011. If enacted in its present

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form, the bill would affect only 100,000 to 200,000 workers -- 0.8 to 1.6% of part-timers or less than 0.31% of the labor force. Answering questions in the Diet, MHLW Minister Yanagisawa was forced to admit that another bill addressing part-timers' concerns would only affect 4-5% of the ostensible target population.

16. (C) Recent efforts to reform the amakudari ("descent from heaven") retirement system, whereby senior bureaucrats are placed in plum private-sector jobs, met a similar fate. Strong opposition from senior bureaucrats and from within the LDP weakened the proposal for a central job bank independent of government ministries, diluted the oversight role of an advisory body, delayed full implementation until 2011, and proposed the repeal of regulations that currently prohibit (for two years) officials from taking employment with certain companies their ministries regulate. A job bank set up in 2000 as part of a similar effort has since placed only one retiring official. As an expatriate government relations consultant commented, there is widespread dislike of the amakudari system, making it a politically popular reform target, but actually reforming it would require a political effort on the scale of former PM Koizumi's push to realize postal privatization. The strongest, most senior bureaucrats stand to lose the most from reform, he concluded, and Abe lacks the brinkmanship and clout Koizumi used to take them on.

#### PM Abe's Style: Chinese Medicine

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17. (C) PM Abe's own public rhetoric on economic reform has moderated as well. In a one-hour interview with NHK in March, Abe distanced himself somewhat from PM Koizumi's economic reforms, describing them as strong medicine that, while necessary and effective, also had had unpleasant side effects on Japanese society. The Prime Minister compared his own agenda, in contrast, to Chinese medicine: slow and gentle, with results showing themselves over time. Such an approach, he said, matched his mild temperament.

18. (SBU) Apparently taking a cue from PM Abe, Economic and Fiscal Policy Minister Hiroko Ota recently told an

interviewer that the CEFP's role had changed since the Koizumi administration, when it was seen as the administration's "engine of reform" in taking on thorny policy issues like the financial crisis, postal privatization, and decentralization. Now, she said, the CEFP was focused on constructing a strategy to raise overall productivity, given Japan's shrinking population. (Note: The CEFP and Council for Promotion of Regulatory Reform may soon provide more detail on the types of policies to be pursued in raising productivity. Both are slated to release interim reports prior to June, when the CEFP is expected to release its policy blueprint for the next year.)

Comment

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19. (C) A CEFP focus on regulations and institutions that retard Japanese productivity could be just as difficult, disruptive, and consequential as Koizumi's economic reform program, and Ota's bland, academic description of the CEFP's role is likely part of an attempt to downplay the committee's profile in the run-up to the Upper House elections. Bread-and-butter economic issues like reform of the pension and social insurance systems have ranked high in recent polling, but former PM Koizumi's structural reforms are routinely blamed in the media for exacerbating "un-Japanese" income and social disparities, and these issues continue to resonate with the electorate. Ironically, however, as Abe hesitates on economic reform, he is seen as ineffectual and his popularity has decreased. The longer-term question is whether PM Abe will take on the tough structural battles after the election. So far the cry of "don't stop reform"

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that delivered the LDP's stunning victory in the 2005 Lower House elections has remained noticeably missing from the LDP's campaign rhetoric, and Abe's failure to maintain the political momentum for reform has empowered the bureaucracy and status quo elements of the LDP. This raises the political cost and difficulty of any post-election effort to re-energize the process of economic restructuring.

SCHIEFFER